PRIVY COUNCIL REPORTS

T.H. LIMITED v. COMPTROLLER OF INCOME TAX

[P.C. (Lord Keith of Kinkel, Lord Elwyn-Jones Lord Brandon of Oakbrook, Lord Brightman and Lord Templeman) January 25 & 26; February 15, 1984]

[Privy Council Appeal No. 49 of 1982]

Revenue Law – Income Tax – Claim for deduction of property tax payments by property development company – Company electing to prepare profit and loss accounts on "completed contract method" – Alteration of practice by company – Disallowed by Comptroller – Change in accounting method.

The appellant company was incorporated in 1970 and since its incorporation had elected to prepare its profit and loss accounts by the "completed contract method". This was accepted by the Comptroller of Income Tax. By the completed contract method the expenses directly incurred by the company in relation to a site which is developed, are not charged in the company's profit and loss account year by year as these expenses are incurred. On the other hand no account is taken of the value of the work in progress year by year. Upon completion of the development, all the expenditure relating to the development incurred over the years from the date of acquisition of the site, including the cost of acquisition of the site, is aggregated and deducted from the sale price or market value of the completed development. The difference between the aggregate expenditure incurred in respect of the development and the proceeds of the sale or market value of the completed development constitutes a profit which the company then includes in its profit and loss account for the year of completion.

Thus between 1970 and 1973 the property tax payable in respect of the development sites was not charged against the company's profit in each year of payment as part of the general administration expenses of the company but was included in the costs and expenses of the development carried out or planned on a particular site and fell to be deducted from the proceeds of sale or market value of the development for the purpose of arriving at the net profit of that development included in the income of the company in the year of completion of the development.

For the tax year 1975 (in its accounts for 1974) however the company altered its practice in regard to property tax. The property tax in respect of all the development sites was treated as a general administration expense and was brought into the profit and loss accounts for the year 1974 thus reducing the net profit liable to tax for the year 1975. The property tax thus charged against profits for 1974 was $253,979.92.

The Comptroller of Income Tax disallowed the deduction of $253,979.92 from the profits of the company for the year 1974 and insisted that consistent with the completed contract method adopted by the company the property tax payable in respect of each development site should be treated as part of the costs and expenses directly attributable to that development and should only be brought into account on the completion of the development as part of the total cost of the development before arriving at the net profit yielded by the development.

The company appealed to the Board of Review and thence to the High Court and to the Court of Appeal without success – see [1981] 2 M.L.J. 105 and [1982] 1 M.L.J. 303. The company then appealed to the Privy Council.

Held, dismissing the appeal: (1) there is a fundamental contradiction between the completed contract method which calculates the ultimate profit derived from each development, taking into account all direct costs and the company's contention that some items of general expenditure should be omitted from those calculations and treated as part of the general expenses of the company;

(2) in the present case the company is not being asked to abandon the completed contract method but to apply it uniformly and consistently.

Cases referred to:

(1) *Vallambrosa Rubber Co. Ltd.* v. *Farmer* (1910) 5 T.C. 529.
(2) *Whimster & Co.* v. *Commissioners of Inland Revenue* (1925) 12 T.C. 813
(3) *Odeon Associated Theatres Ltd.* v. *Jones* (1969) 48 T.C. 257
(4) *Duple Motor Bodies Ltd.* v. *Ostime* (1959) 39 T.C. 537.

PRIVY COUNCIL APPEAL FROM SINGAPORE.

Steward Bates Q.C. (*Andrew Ang* and *John Tallon* with him) for the appellant.

Andrew Park Q.C. (*Mrs. Lucy Hangchi* with him) for the respondent.

Cur. Adv. Vult.

Lord Templeman (delivering the judgment of the Board): This appeal concerns the correct treatment of property tax in the profit and loss accounts of the appellant company, Thomson Hill Ltd. That company was incorporated in Singapore on April 15, 1970 and carried on business as housing developers. From time to time the company purchased housing sites, some of which have been developed, others are in course of development, and others are being retained with a view to development in the future. The company elected, and the respondent Comptroller of Income Tax accepted, that the profit and loss accounts of the company should be prepared by the "completed contract method". Even if it were permissible for the company to change to some other method of calculating its profits, the company is not desirous of making any change.

By the completed contract method the expenses directly incurred by the company, in relation to a site which is developed, are not charged in the company's profit and loss account year by year as those expenses are incurred. On the other hand no account is taken of the value of the work in progress year by year. Upon completion of the development, all the expenditure relating to the development incurred over the years from the date of acquisition of the site, including the cost of acquisition of the site, is aggregated and deducted from the sale price or market value of the completed development. The difference between the aggregate expenditure incurred in respect of the development and the proceeds of sale or market value of the completed development constitutes a profit which the company then includes in its profit and loss account for the year of completion. For example, on March 16, 1970 the company purchased for $3 million a site of 28 acres at Lorong Chuan, Lot 2284, for the purposes of a housing development known as the Golden Hill project. Between 1970 and 1974 the company was engaged in carrying out the development of the site at a cost exceeding $6 million which were not charged against the profits of the company. In 1974 phases 1, 2 and 3 of the Golden Hill project were completed and the profits of the company for that year included a sum exceeding $7.6 million, representing the difference between the cost of the completed parts of the Golden Hill project, including an apportioned part of the 1970 acquisition cost, and including all the costs and expenditure directly attributable to the project between 1970 and 1974 on the one hand, and the proceeds of sale or market value of the completed parts of the project when they were completed in 1974.

Between 1970 and 1974 the company incurred and paid costs and expenses which were not directly attributable to any particular development site. For example, the company paid salaries to its headquarters staff, purchased company stationery and maintained company vehicles and office equipment generally. These general administration expenses of the company were not apportioned to the various development projects which were being carried out but, in accordance with admittedly sound accounting principles, were charged in the year of expenditure in the profit and loss account of the company. The income of the company for the years 1970 to 1973 was very small because none of the development projects was completed and in accordance with the completed contract method no profit could be taken into account in respect of any development prior to its completion. There was little income to set against the general administration expenditure in each year. Consequently the profit and loss accounts showed a loss for each year which loss was carried forward. In the year 1974 however completion of phases 1 to 3 of the Golden Hill project provided, as already indicated, a profit relating to that project of over $7.6 million and that profit was, in accordance with the principles of the completed contract method, brought into the profit and loss account of the company for the year 1974. In the result the net profit for 1974 was a sum exceeding $4 million liable to income tax in the tax year 1975 subject to setting off the losses made in previous years.

By the Property Tax Act, a property tax, at a rate from time to time determined by the government upon the annual value of all lands and buildings as set forth in a valuation list prepared for that purpose, is payable by the owner of the land and is enforceable by, *inter alia*, a sale of the land charged with the tax. Thus between 1970 and 1973 the company paid property tax assessed in respect of the site of the Golden Hill project. That tax was directly attributable to the project and was not part of the general administration expenses of the company. The aggregate amount of the property tax paid in respect of the Golden Hill project was therefore not charged in the profit and loss accounts of the company between 1970 and 1973 but was included in the aggregate costs and expenses of the project and served to reduce the net profit which resulted from the Golden Hill project and which was included in the profit and loss account for the company for 1974. But for the property tax paid in respect of the Golden Hill project the net profit disclosed in 1974 of $7.6 million would have been higher by the amount of tax paid between the acquisition of the site in 1970 and the completion of the project in 1974.

Similarly between 1970 and 1973 the property tax payable in respect of every other development site held by the company was not charged against the company's profits in each year of payment as part of the general administration expenses of the company but was included in the costs and expenses of the development carried out or planned for that site and fell to be deducted from the proceeds of sale or market value of the development for the purposes of arriving at the net profit of that development included in the income of the

company in the year of completion of the development.

For the tax year 1975 the company submitted accounts for the year 1974. In those accounts the company altered its practice with regard to property tax. The tax paid during 1974 in respect of each and every development site was not included in the expenditure attributable to that site to be taken into account on completion of the development. Instead the tax paid in respect of all the company's development sites was treated as a general administration expense of the company and was brought into the profit and loss account for the year 1974 thus reducing the net profit liable to income tax for the tax year 1975. The property tax thus charged against profits for 1974 was $253,979.92.

The Comptroller of Taxes disallowed the deduction of $253,979.92 from the profits of the company for 1974 and insisted that, consistent with the completed contract method adopted by the company, the property tax payable in respect of each development site should be treated as part of the costs and expenses directly attributable to that development and should only be brought into account on completion of the development as part of the total cost of the development before arriving at the net profit yielded by the development.

The company appealed to the Board of Review and thence to the High Court (Chua J.) and to the Court of Appeal of the Republic of Singapore (Wee Chong Jin C.J., and Kulasekaram and Rajah JJ.) without success. The company now appeals to the Board.

The principle which inspires the completed contract method is that a project does not yield a profit or an income until the project has been completed and proceeds of sale are or can be realised. Until completion, that is until profit or income can be realised, revenue is not recognised or attributed to enhanced work in progress and on the other hand costs and expenses are not brought into account. There is thus no need to value work in progress from year to year in order to arrive at the profit for that year. Profit only arises when the contract or development is completed.

Property tax in respect of a development site is part of the overall cost of the development. The cost to the developer includes the purchase price, the expenses incurred by the developer in respect of the site and the expenses involved in carrying out on the site the housing and other works which must be carried out before the development is completed. If, in respect of the Golden Hill project, the company wished to ascertain whether the project had yielded a profit or a loss the company would have been bound to compare all the money which the company had paid out to acquire and hold and develop the site with the proceeds of sale received by the company for the development after completion. Similarly, in respect of every other site held by the company, the company will not show any income until the development is completed. The amount of that income will be the difference between all the costs incurred by the company, in respect of the site and the development between the date of acquisition of the site and the date of completion of the development on the one hand, and the net proceeds of sale realised or realisable by the company on completion of the development on the other hand.

On behalf of the company it was submitted that the completed contract method did not require comparison between costs and proceeds of sale but only a comparison between expenditure which enhanced the value of the site and the proceeds of sale. This submission was based on an assertion by an accountant who gave evidence for the company. There is no basis for such an assertion. The profit of a housing developer who elects to employ the completed contract method of accounting involves the calculation of the amount of profit earned by each separate development as a result of purchasing, holding, developing and selling the building site which is the subject of the development. That profit cannot be fairly calculated by leaving out of account some items of expenditure, such as property tax, which are directly attributable to the site and are incurred and paid in the course of the development. It was submitted that if the property tax for each development was treated as part of the development costs, the accounts of a company pending completion of the development would be "distorted". There can be no distortion of the profit and loss accounts of the company prepared pursuant to the completed contract method save for the inevitable distortion caused by the method itself which involves paying no regard in the profit and loss accounts, prior to completion of a development, to expenditure incurred or to the value of work in progress. But in fact the expenditure incurred in respect of each development site of the company pending com-

pletion was set out in the schedules of fixed assets and schedules of development expenditure annexed to the accounts so that any purchaser, shareholder or creditor could ascertain the total amount expended on any development from time to time. If a shareholder, purchaser or creditor were interested in valuing a partly developed site he would not derive any reliable information from profit and loss accounts prepared pursuant to any other method.

The Board was reminded by Mr. Bates who appeared for the company that a taxpayer must compute the "full amount" of his income for each tax year (section 35(1) of the Income Tax Act) and shall deduct for any period:–

"... all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of the income."

But the completed contract method of computing income is accepted by the Comptroller of Taxes and by the company and its advisers and was approved by the Statement of Standard Accounting Practice No. 9 issued by the Institute of Chartered Accountants of England and Wales and by the International Accounting Exposure Draft No. 12 issued by the International Accounting Standards Committee. Pursuant to that approved method no income of the company arises from a development until that development is completed. Outgoings and expenses directly attributable to that development are not deductible from the income of the company as they arise but are only taken into account in arriving at the profit derived from the development and that profit constitutes part of the income of the company in the year of completion and not in any previous year.

Mr. Bates endeavoured to obtain some support from the advice contained in the Statement of Standard Accounting Practice No. 9 issued by the Institute of Chartered Accountants in England and Wales and the International Accounting Standard Exposure Draft 12 issued by the International Accounting Standards Committee. In those documents, however, and in particular in the exposure draft, where the completed contract method is discussed, a clear distinction is drawn between costs which are directly attributable to a particular contract or, in the present case, a particular development, and costs which form part of the general administration of the contractor. The costs directly attributable to a particular contract are only to be taken into account when, upon completion of the contract, the total cost of the contract is compared with the proceeds of sale or market value of the completed contract so as to arrive at the profit derived from the contract, which profit is then brought into the profit and loss account of the company for the year of completion.

The general administration costs of the company and any other items of expenditure which are not directly attributable to a particular contract are debited in the profit and loss account of the company in the year of expenditure. Neither document justifies the assertion that in the completed contract method some costs which are directly attributable to the contract and nothing else are not to be taken into account in the final computation of profit but are to be treated as though they were general expenses of the company, simply because they do not enhance the value of the site which is in course of development. Their Lordships consider that the company's present assertion is inconsistent with the principles of the completed contract method and that accounts prepared on the basis of the company's present assertion would give a misleading impression of the profitability of a particular development and a misleading impression of the company's profits in the years preceding completion of a contract.

Mr. Bates agreed that the present appeal involved the company in disputing the accuracy of the accounts prepared by the company for the tax years 1971 to 1974. He also agreed that the present appeal only referred to property tax but there were other items of expenditure, such as mortgage interest and quit rent, which could not be said to enhance the value of the site and ought, according to the views now expressed by the company, to be brought into the profit and loss accounts of the company in each year of expenditure.

The Lordships are satisfied that there is a fundamental contradiction between the completed contract method which calculates the ultimate profit derived from each development, taking into account all direct costs, and the company's present assertion that some items of direct expenditure should be omitted from those calculations and treated as part of the general expenses of the company.

Mr. Bates also sought unsuccessfully for some assistance from authority. *Vallambrosa Rubber Co. Ltd.* v. *Farmer*[1] decided that where only one-

seventh of a rubber estate produced rubber in each year, the rest lying fallow, the cost of maintaining the whole estate was a deductible expense in arriving at the taxable profits of the rubber producing business. The decision did not involve consideration of the completed contract method and does not call for comment. *Whimster & Co.* v. *The Commissioners of Inland Revenue*[2], decided that a taxpayer was not entitled to reduce his profits earned in 1920 by deduction for a loss the taxpayer expected to sustain the following year. Mr. Bates prayed in aid of the general principles enunciated by the Lord President Lord Clyde, at page 823, namely: –

"In computing the balance of profits and gains for the purposes of Income Tax ... two general and fundamental common-places have always to be kept in mind. In the first place, the profits of any particular year or accounting period must be taken to consist of the difference between the receipts from the trade or business during such year or accounting period and the expenditure laid out to earn those receipts. In the second place, the account of profit and loss to be made up for the purpose of ascertaining that difference must be framed consistently with the ordinary principles of commercial accounting, so far as applicable, and in conformity with the rules of the Income Tax Act ... For example, the ordinary principles of commercial accounting require that in the profit and loss account of a merchant's or manufacturer's business the values of the stock-in-trade at the beginning and at the end of the period covered by the account should be entered at cost or market price, whichever is the lower; although there is nothing about this in the taxing statutes."

In the present case the recognised and accepted completed contract method leaves the calculation of profit until the year of completion and obviates the necessity for valuation of work in progress or of land which is in effect stock in trade. The principles of commercial accounting applicable to the completed contract method require, in the opinion of their Lordships, the uniform treatment of costs and expenses attributable to a particular project, whether those costs and expenses can be said to enhance the value of the subject matter of the project or not. Like all other costs and expenses, including the initial cost of the land, they will be brought into account upon completion of the project and calculation of the profit earned.

In *Odeon Associated Theatres Ltd.* v. *Jones*[3] the cost of repairs made necessary by neglect prior to the date of acquisition were held to be a deductible income expense and not capital expenditure. Sir John Pennycuick V.C., at page 273, discussed the application of accountancy principles in the light of evidence from accountants themselves. In the present case there is a conflict of evidence between accountants and the evidence given by one accountant on behalf of the company consisted of an unsatisfactory assertion unsupported by authority and unjustified by practice or principle.

In *Duple Motor Bodies Ltd.* v. *Ostime*[4] a taxpayer who used the direct cost method of ascertaining the cost of work in progress under which the cost of direct materials and labour were alone taken into account was held not to be compellable by the Commissioners to adopt the on cost method under which a proportion of indirect expenditure i.e. factory and office expenses etc. are added to the direct cost. In the present case the company is not being asked to abandon the completed contract method but to apply it uniformly and consistently.

Mr. Bates referred to the speech of Viscount Simonds in which he pointed out that the on cost method might lead to an absurd conclusion. But in the present case the inclusion of property tax in the costs and expenses directly attributable to a particular project does not produce an absurd conclusion. On the contrary if property tax as it arises is debited in the profit and loss account of the company for each year that account will present a distorted view of the company's profit for that year and when the net profit from a project is arrived at upon completion that profit will be distorted if the incidence of property tax is ignored.

All the courts below reached the same conclusion for the same reasons. The appeal, notwithstanding Mr. Bates' vigorous presentation, must be dismissed with costs

Appeal dismissed.

Solicitors: *Norton, Rose, Botterell & Roche; Jacques & Lewis.*